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ABSTRACT

This report analyzes repayment patterns for federally supported student financial aid distributed through the William D. Ford Federal Direct Loan Program (FDLP), which includes an income-contingent repayment (ICR) plan that ties borrowers' monthly payments to income, family size, and loan amount. This report analyzes 3 year usage of ICR in relation to three other repayment plans generally available to FDLP borrowers: standard repayment, extended repayment, and graduated repayment. The report notes that 9 percent of borrowers (n=56,298) were using ICR; of that group about 80 percent were current in monthly payments. ICR borrowers tended to be delinquent or in default at higher percentages than borrowers using other repayment plans. Borrowers who had been placed in the ICR program because of prior defaults on other types of loans were the major factor in this higher rate of delinquency. The report also noted that comparing estimated total loan payments of ICR users with borrowers using other repayment plans was complicated. Also noted were the two methods used by the Department of Education to check reported income of ICR borrowers. Appendices include information on scope and methodology; FDLP loan data; schools attended by borrowers; and delinquency and default rates of FDLP borrowers. (CH)

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ED 412 877

United States General Accounting Office

GAO

Report to the Chairman, Committee on Education and the Workforce, House of Representatives

August 1997

DIRECT STUDENT LOANS

Analyses of Borrowers' Use of the Income Contingent Repayment Option

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United States
General Accounting Office
Washington, D.C. 20548

Health, Education, and
Human Services Division

B-277321

August 21, 1997

The Honorable William F. Goodling
Chairman, Committee on Education
and the Workforce
House of Representatives

Dear Mr. Chairman:

The William D. Ford Federal Direct Loan Program (FDLP), established by the Student Loan Reform Act of 1993, contains a unique repayment option. Called the income contingent repayment (ICR) plan, it ties the borrowers' monthly payments to their income, family size, and student loan amount. Under ICR, borrowers with low incomes or high debt loads can fit their student loan payments into their budgets because the size of their payments can expand or contract with their ability to pay.

Now, 3 years after FDLP began, a sizable number of borrowers have begun repaying their loans. You asked us to develop information that would help assess how borrowers have been using ICR. As agreed with your office, we focused our review on the following:

- To what extent are borrowers using ICR compared with other repayment plans available under FDLP?
- How do loan delinquencies and defaults under ICR compare with delinquencies and defaults under other FDLP repayment plans?[1]
- How do borrowers' loan payments under ICR compare with payments under other FDLP repayment plans?
- How does the Department of Education, which administers the program, verify the accuracy of income reported by borrowers using ICR?

We based our review on data supplied by the Department of Education as of March 31, 1997. We analyzed the usage of ICR and compared it with the usage of the three other repayment plans generally available to FDLP borrowers—standard repayment (10 years, fixed monthly payment), extended repayment (up to 30 years depending on amount borrowed, fixed monthly payment), and graduated repayment (up to 30 years depending on amount borrowed, with low initial monthly payments that increase

[1]Borrowers are delinquent if they have not made a payment for 31 to 180 days and in default if they have not made a payment for more than 180 days. However, loans in default for more than 270 days were not part of the databases we analyzed. After 270 days, loan records are transferred from the FDLP loan service center to the Department of Education's Debt Collection Service (DCS) unit.

generally every 2 years). Appendix I describes our scope and methodology in further detail.

Results in Brief

As of March 31, 1997, about 663,000 borrowers owing about $5.3 billion in FDLP loans were repaying loans. About 9 percent, or 56,298, of these borrowers were using ICR. As a group, they differed from most borrowers in two key respects. First, they were much more likely to have direct consolidation loans, which are multiple loans combined into a single loan for repayment purposes and are generally much larger than other loans. Second, about 40 percent, or 23,678, of the 56,298 ICR users had been placed into this plan because they were in default on loans from the Federal Family Education Loan Program (FFELP). We found little relationship between the type of school attended by FDLP nonconsolidated loan borrowers and their selection of ICR as a repayment plan. However, nonconsolidated loan borrowers from 2-year public schools were somewhat more inclined to select the ICR plan than were borrowers from other kinds of schools.

We found that about 80 percent (44,379 of 56,298) of borrowers using ICR either were current in their monthly payments or had their payments suspended because they were in school or for other reasons. However, borrowers using ICR tended to be delinquent or in default at higher percentages than borrowers using other repayment plans. More specifically, about 16 percent, or 9,807, of the 56,298 borrowers using ICR were delinquent (made no payment for 31 to 180 days), and another 5 percent, or 2,832, were in default (made no payment for 181 to 270 days).[2] Borrowers using the other plans were delinquent at rates ranging from 9.1 percent (1,838 of 20,139 extended plan users) to 14.8 percent (77,923 of 527,351 standard plan users) and in default at percentages ranging from 0.8 percent to 1.4 percent (158 and 7,534, respectively). Borrowers who have been placed into the ICR plan because they have defaulted on an FFELP loan are a major factor in the higher percentage of defaults for ICR users; of the 2,832 borrowers using ICR and in default, 2,083, or 73.6 percent, had defaulted on an FFELP loan.

Comparing estimated total loan payments for ICR users and borrowers who use the three other repayment plans is complicated. Compared with

[2]This contributes to understating the percentage of loans in default because default loans in arrears for more than 270 days are excluded. The percentage of FDLP loans in default discussed in this report is different from the default rates the Department of Education computes. For computing school default rates, the Department includes borrowers who have not made a payment for 270 days or more. This is called the "cohort default rate" as explained in app. I.

borrowers who use the standard repayment plan, ICR users and those using extended and graduated plans generally face higher total payments. Compared with borrowers who use the extended or graduated repayment plans, ICR users face comparatively higher total payments if their incomes are low but comparatively lower total payments if their incomes are high. However, ICR borrowers (and their spouses) with family incomes that remain low over a long period of time do not have to repay all their principal and interest if the maximum payback period of 25 years expires before the full amount is paid off. In contrast, ICR borrowers whose income increases substantially during the repayment period would make increasingly higher monthly payments, and this could result in repayment of the loan in full by the end of the 25-year repayment period.

The Department of Education checks the reported income of borrowers using ICR in one of two ways. For borrowers who are in their first year of repayment or who may have recently lost their jobs, the Department relies primarily on documentation submitted by the borrower, such as pay stubs, dividend statements, or canceled checks. The Department does not verify the accuracy of this documentation when it is submitted; rather, it relies on a signed certification from the borrower that the information is complete and accurate. For borrowers who have been out of school for a year or more, the Department obtains income information directly from the Internal Revenue Service (IRS). The Department does not verify the accuracy of information borrowers provide IRS but relies on IRS' verification process. However, during the transition from using borrower documentation to using IRS information, the Department compares the income amounts from the two sources for discrepancies. If there are significant discrepancies or if borrowers do not cooperate in providing correct income information, they are removed from the ICR plan and placed into another repayment plan.

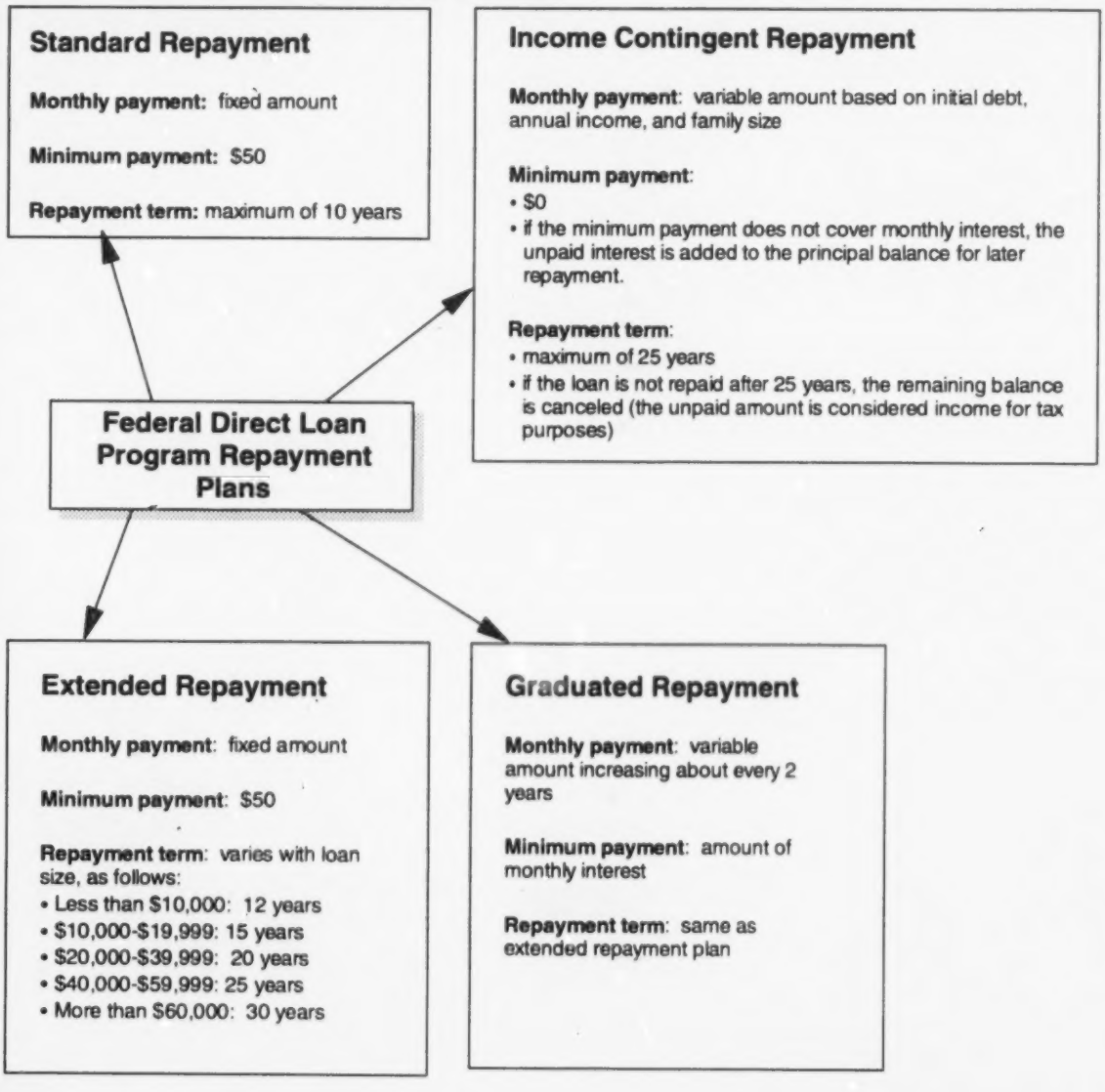
Background

In fiscal year 1996, students and their families used federal student loan programs to borrow approximately $30 billion to pay for postsecondary education. FDLP is one of two main approaches the federal government has taken to make loans available for college. Under this program, students or their parents borrow money directly from the government through the schools the students attend. The other major program, FFELP, provides loans through private lenders, and the federal government guarantees repayment if borrowers default. According to a Department official, FDLP accounted for about 32.1 percent of student loan volume in fiscal year 1996.

Most FDLP borrowers can select one of four repayment options, as illustrated in figure 1.[3] These four options differ by the amount of time allowed to repay loans and the flexibility of the payment schedule. The ICR option is the most flexible. It allows borrowers to pay relatively small or no monthly payments when their incomes are low and to pay more when their incomes rise. For example, a married borrower with a loan balance of $20,000 and an annual family income of $15,000 would initially pay about $77 a month. If the borrower's annual income were $45,000, the initial monthly payment would be about $225.

[3]Not all repayment options are available for each kind of FDLP loan. For example, the ICR plan is not available for FDLP PLUS or PLUS consolidation loans, which are made to students' parents.

Figure 1: Basic Characteristics of FDLP Repayment Options


Standard Repayment
Monthly payment: fixed amount
Minimum payment: $50
Repayment term: maximum of 10 years
Income Contingent Repayment
Monthly payment: variable amount based on initial debt, annual income, and family size
Minimum payment:
• $0
• if the minimum payment does not cover monthly interest, the unpaid interest is added to the principal balance for later repayment.
Repayment term:
• maximum of 25 years
• if the loan is not repaid after 25 years, the remaining balance is canceled (the unpaid amount is considered income for tax purposes)
Federal Direct Loan Program Repayment Plans
Extended Repayment
Monthly payment: fixed amount
Minimum payment: $50
Repayment term: varies with loan size, as follows:
• Less than $10,000: 12 years
• $10,000-$19,999: 15 years
• $20,000-$39,999: 20 years
• $40,000-$59,999: 25 years
• More than $60,000: 30 years
Graduated Repayment
Monthly payment: variable amount increasing about every 2 years
Minimum payment: amount of monthly interest
Repayment term: same as extended repayment plan

For our analysis,we classified FDLP loans into three main categories.

- Direct nonconsolidated loans: These are the basic FDLP loans with which students or their parents can help finance postsecondary education. There are three kinds: subsidized and unsubsidized direct Stafford loans and direct PLUS loans. Direct subsidized Stafford loans, available only to students with a demonstrated financial need, are subsidized in that the federal government does not charge interest while the student is in school at least half-time, during a 6-month grace period after the student graduates or otherwise leaves school, and during periods in which loan repayment is deferred (such as when the borrower is seeking but unable to find full-time employment). In contrast, direct unsubsidized Stafford loans, which are available to all students regardless of financial need, do not include an interest subsidy. If the borrower does not make interest payments while in school, the interest is added to the principal balance to be repaid as part of the total loan amount. Direct PLUS loans are available to parents of dependent students to help pay for their children's education; they are unsubsidized because parents are responsible for paying all interest charges.
- Direct consolidation loans: During the course of their education, students can obtain loans from more than one program. By obtaining a direct consolidation loan, borrowers can combine their loans and make only one monthly payment. Borrowers can consolidate their loans while they are in school or afterward, and the interest on their consolidation loans can be subsidized or unsubsidized, depending on the kind of original loans they consolidated. Borrowers in default on a student loan who have made satisfactory arrangements to repay the defaulted loan, or who agree to repay under the ICR plan, can also obtain direct consolidation loans. Parents with multiple PLUS loans can combine them into a single direct PLUS consolidation loan.
- Debt Collection Service (DCS) consolidation loans: These are direct consolidation loans to borrowers who previously defaulted on their FFELP loans and whose loans were assigned to the Department's DCS for collection. In fiscal year 1995, the Department began to increase collections on defaulted FFELP loans by offering direct consolidation loans to these borrowers so they could make more affordable payments through the ICR plan.

As shown in table 1, the vast majority (83.6 percent) of FDLP borrowers in repayment had nonconsolidated loans as of March 31, 1997. These borrowers represented about 69 percent of the total direct loan volume in repayment. However, borrowers with direct consolidation loans had

average loan amounts that were much higher than those of the two other kinds of borrowers—$21,807 compared with $6,611 and $5,453. Such borrowers had more than 26 percent of total loan volume, even though they were only about 10 percent of all borrowers.

Table 1: FDLP Loans in Repayment, as of March 31, 1997

	Borrower		Original loan amount		Average loan amount
Loan category	Number	Percentage of total	Millions of dollars	Percentage of total	
Direct nonconsolidated	554,461	83.6	$3,665.3	69.0	$6,611
Direct consolidation	64,430	9.7	1,405.0	26.4	21,807
DCS consolidation	44,407	6.7	242.1	4.6	5,453
Total	**663,298**	**100.0**	**$5,312.5[a]**	**100.0**	

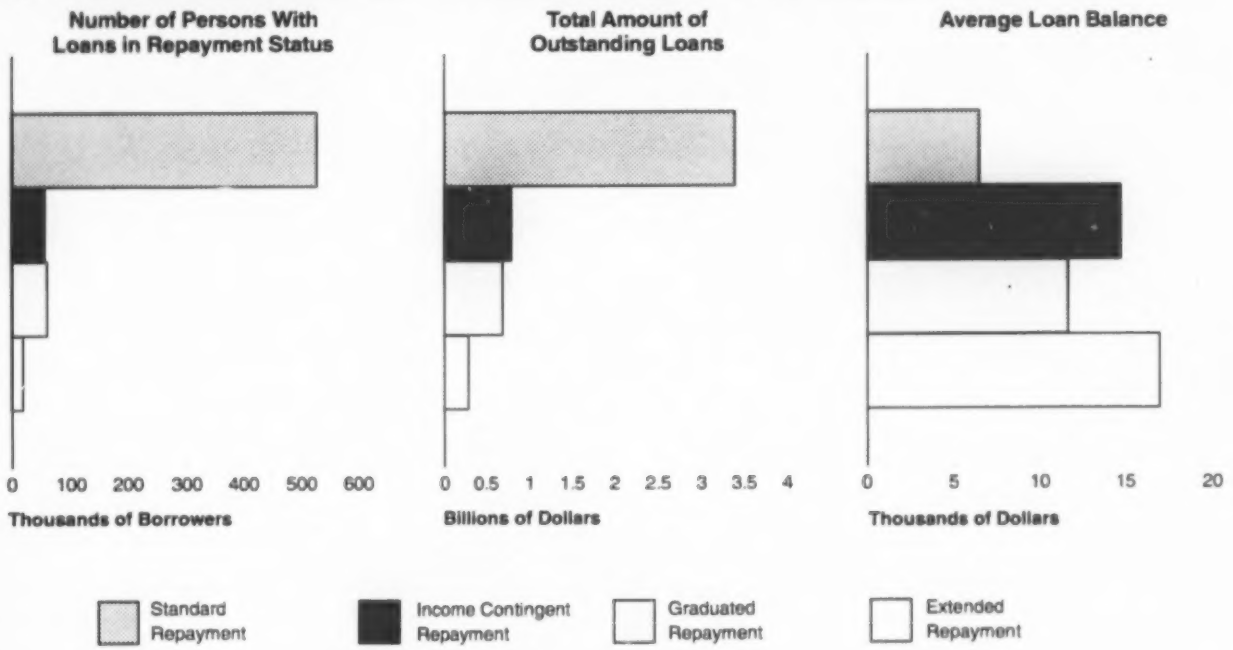
[a]Numbers do not add to total due to rounding.

ICR Used by About 9 Percent of FDLP Borrowers

As of March 31, 1997, slightly more than 56,000 borrowers in repayment were using ICR—about 9 percent of the total (see fig. 2). Collectively, these borrowers accounted for about $831 million in outstanding loans, or about 16 percent of the $5.3 billion of FDLP loans in repayment. Borrowers using the standard plan were the largest in number and loan volume among the four plans. However, the average size of their loans (about $6,530) was considerably smaller. By comparison, loans held by ICR users averaged about $14,770.[4] Borrowers using the extended plan had the highest average balance (about $17,000).

[4]For details on the distribution of borrowers and loan amounts among the various repayment plans, see app. II.

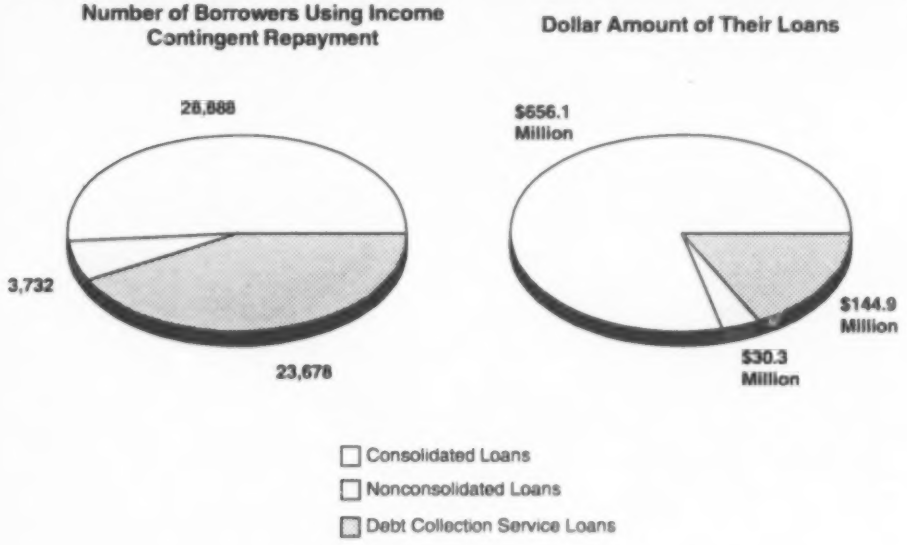
Figure 2: Distribution of Borrowers and Loan Amounts for Each FDLP Repayment Option, as of March 31, 1997


Number of Persons With Loans in Repayment Status
0 100 200 300 400 500 600
Thousands of Borrowers
Total Amount of Outstanding Loans
0 0.5 1 1.5 2 2.5 3 3.5 4
Billions of Dollars
Average Loan Balance
0 5 10 15 20
Thousands of Dollars
Standard Repayment
Income Contingent Repayment
Graduated Repayment
Extended Repayment

Many ICR Users Had Direct or DCS Consolidation Loans

Borrowers using ICR differed from most other FDLP loan borrowers in repayment in several important ways. More than half (51 percent) were borrowers with direct consolidation loans (see fig. 3). In contrast, only about 8.5 percent of all borrowers in FDLP had such loans. Borrowers with direct consolidation loans held nearly 80 percent of total dollar volume of loans being repaid under ICR. Another large portion (about 42 percent) of borrowers using the ICR plan were those with DCS consolidation loans. However, these borrowers had relatively small average loan amounts ($6,100 compared with $23,000 for direct consolidation loans) and held only 17 percent of the total loan volume being repaid under ICR. Only about 7 percent of borrowers using ICR held nonconsolidated loans.

Figure 3: Distribution of Borrowers and Amounts in Repayment Under ICR, as of March 31, 1997



Limited Data Suggest ICR Users Not Concentrated in Particular Types of Schools

Information on the kinds of schools that ICR users attended is limited to borrowers who had nonconsolidated loans. According to a Department official, the Department does not track repayment plan data by school for direct and DCS consolidation loans. Because students whose previous loans were combined into either a direct or DCS consolidation loan sometimes have attended more than one school, classifying loans by kind of school is difficult and not very meaningful.

Data on FDLP borrowers with nonconsolidated loans show little relationship between the type of school attended and a borrower's selection of ICR as a repayment plan. For the most part, there was little variation between the various repayment plans when compared by type of school, such as public and private or 2-year and 4-year. The data did show that borrowers from 2-year public schools were somewhat more inclined to select the ICR plan than were borrowers from other kinds of schools. However, since nonconsolidated loan recipients represented less than

10 percent of ICR users, it is unclear whether they represented ICR users as a whole.[5]

Delinquencies and Defaults Under ICR Are Higher Than Under Other Repayment Plans

Across all four types of repayment plans, 14.4 percent of FDLP borrowers were delinquent and 1.7 percent were in default, according to the Department data in our analysis. (See table 2.) About 70 percent of borrowers were current on their loan payments, and another 13.7 percent were currently not paying because their payments had been postponed through statutorily provided deferment or forbearance procedures. The data we analyzed generated an understated percentage of loans in default because only defaulted loans in arrears for 181 to 270 days are included. According to a Department official, loans in arrears for longer than 270 days had been transferred to the Department's DCS and, therefore, data on these loans were not contained in the database we used for our analysis.[6] This official said that, as of March 31, 1997, about $34.6 million in such defaulted loans had been transferred to DCS. Thus, when these defaulted loans are combined with the $71 million in loans that were in default for 181 to 270 days, the total of defaulted direct loans is about $105.6 million.

Table 2: Status of FDLP Loans in Repayment, as of March 31, 1997

		Borrower		Original loan amount	
Repayment status	**Explanation**	**Number**	**Percentage of total**	**Amount (in millions)**	**Percentage of total**
Current	Payment on time	466,339	70.3	$3,735.1	69.9
Default	Payment not made for 181-270 days	11,026	1.7	71.0	1.3
	Payment not made for over 270 days	[a]	[a]	34.6	0.6
Delinquent	Payment not made for 31-180 days	95,328	14.4	660.4	12.4
Deferment and forbearance	Payment postponed because borrower is in school or for other reasons	90,605	13.7	846.0	15.8
Total		**663,298**	**100.0[b]**	**$5,347.1**	**100.0**

[a]Not available.

[b]Percentages do not add to 100 due to rounding.

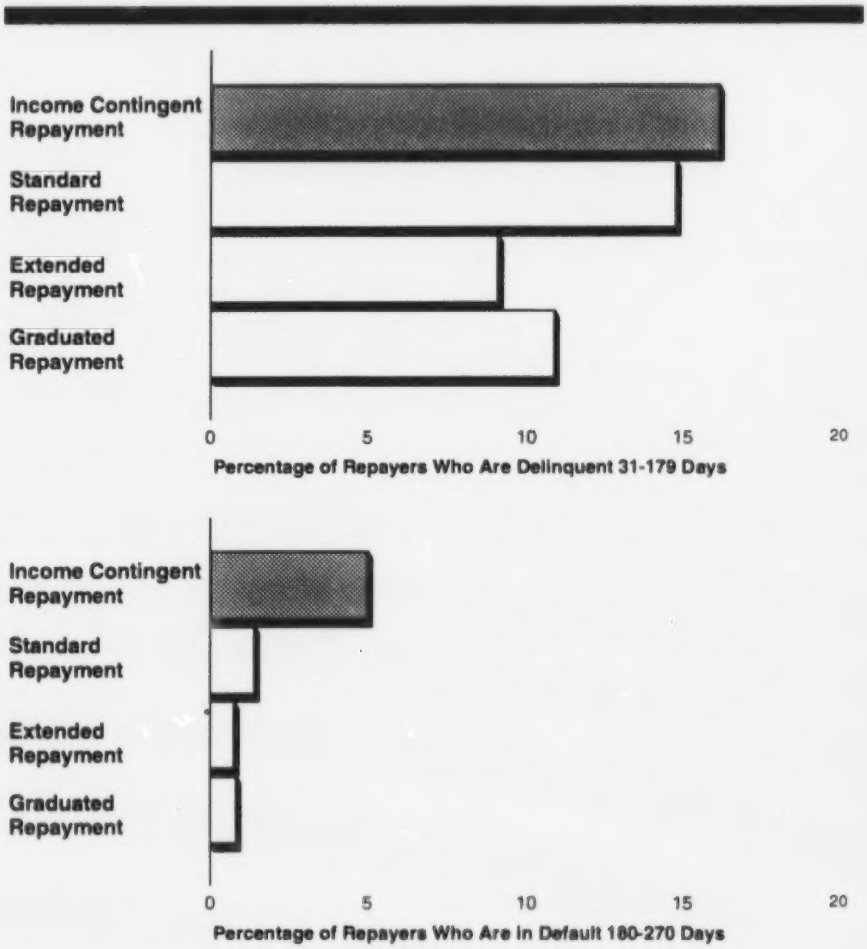
[5]For details on how nonconsolidated loan borrowers in FDLP were distributed by repayment option by type of school, see app. III.

[6]For information on the Department's use of separate data systems, see Department of Education: Multiple, Nonintegrated Systems Hamper Management of Student Financial Aid Programs (GAO/T-HEHS/AIMD-97-132, May 15, 1997).

It is important to note that the percentage of FDLP loans in default we computed in our analysis is different from the default rate the Department computes. There are two major differences. First, our computation of loans in default reflects only borrowers who have not made a payment for 181 to 270 days, but the Department's default rates include borrowers who have not made a payment for more than 270 days. Second, the percentage of borrowers in default that we computed for FDLP is a simple percentage (number of borrowers in default divided by the total number of borrowers in repayment at a single point in time). In contrast, the Department's default rates are computed for a cohort of borrowers over a period of time. (This is explained in app. I.)

Compared with the three other payment plans, the overall percentage of loans that were delinquent or in default under ICR were higher (see fig. 4). The delinquency rate among ICR users was 16.1 percent, and the percentage of loans in default was 5.0. By comparison, the next highest delinquency rate was 14.8 percent (for borrowers using standard repayment), and the next highest percentage of loans in default was 1.4 (also for borrowers using standard repayment).

Figure 4: Comparison of the Percentage of FDLP Loans That Were Delinquent and in Default for Each Repayment Plan



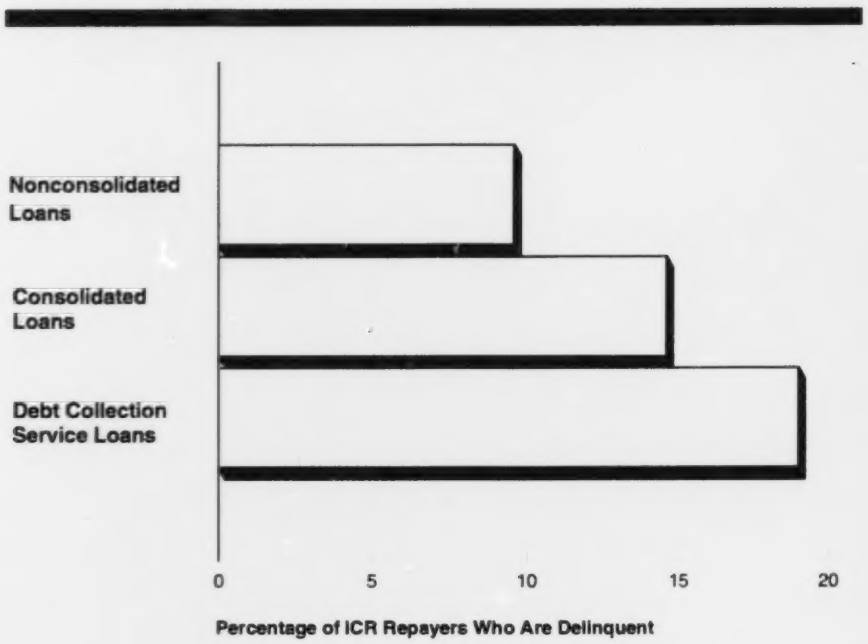
There appear to be two possible explanations for why borrowers using ICR, as a group, have overall higher delinquencies and defaults than borrowers using the other repayment plans. First, a higher concentration of borrowers with DCS consolidation loans uses the ICR plan than the other repayment plans (53 percent, or 23,678, of 44,407 DCS consolidation loan borrowers are using ICR), and, as we discuss below, borrowers of these kinds of loans have the highest percentage of loans that are delinquent and

in default. Second, the exclusion of PLUS loan borrowers, who according to Department officials tend to have lower delinquency and default rates than student borrowers, from the ICR plan could tend to make delinquencies and defaults of the other plans lower relative to the rates of the ICR plan.

Considerable Variances in Delinquencies and Defaults by Type of ICR Loan

Among borrowers using ICR, there is considerable variance in delinquency rates, depending on the type of loan (see fig. 5). Of the three categories of loans in repayment (nonconsolidated, direct consolidation, and DCS consolidation), the highest delinquency rate was for borrowers with DCS consolidation loans (about 19 percent). ICR users with direct consolidation and nonconsolidated loans had significantly lower delinquency rates (14.6 percent and 9.6 percent, respectively). Given that the majority (53.3 percent) of borrowers with DCS consolidation loans are ICR users, the overall higher delinquency rate for ICR compared with the other repayment plans could be partly the result of considerably greater involvement of DCS consolidation loan borrowers (borrowers who previously defaulted on FFELP loans) in the ICR plan compared with the other repayment plans. (See app. II.)

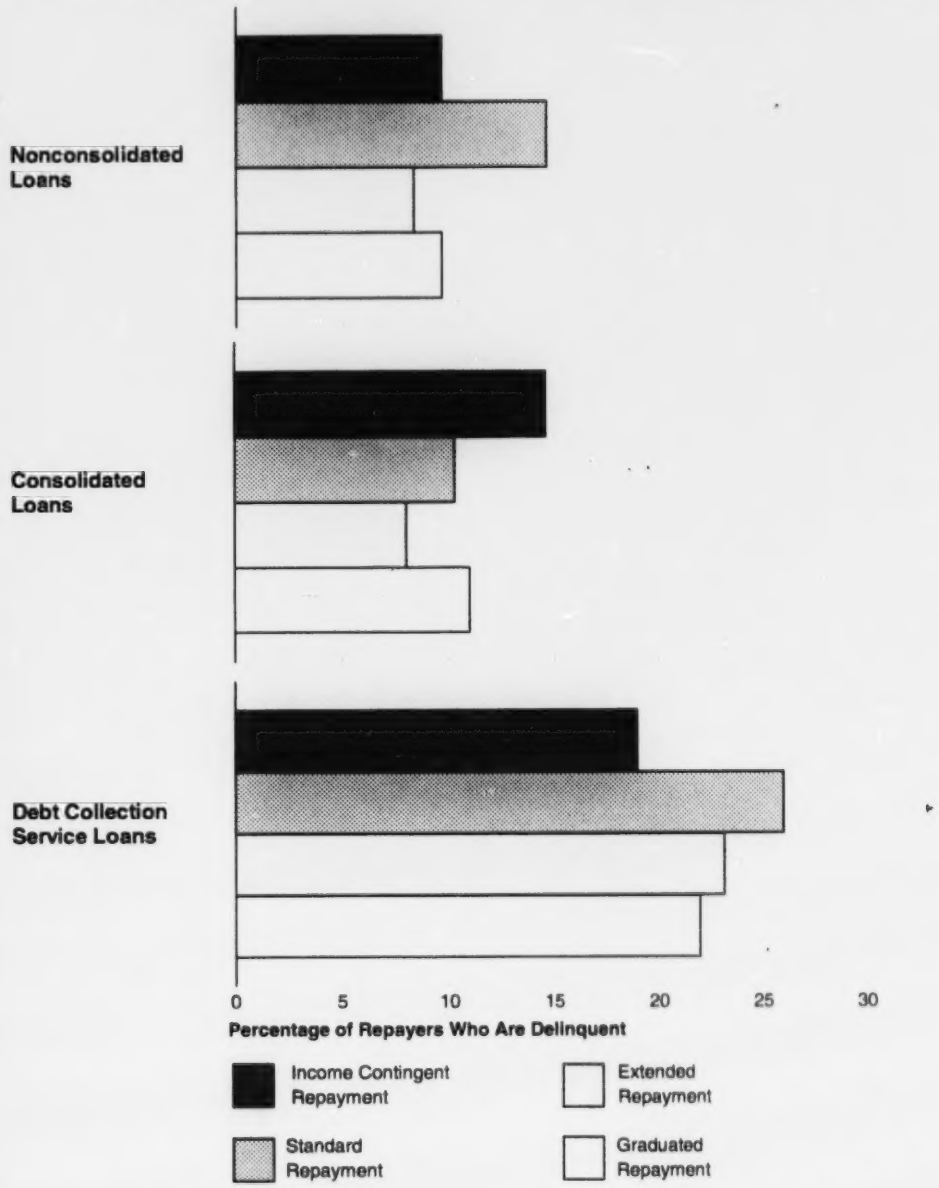
Figure 5: Delinquency Rates of Borrowers Using ICR, as of March 31, 1997



A comparison of individual types of loans shows that ICR users do not have higher delinquency rates than users of all other repayment plans (see fig. 6). For example, for nonconsolidated loans alone, the delinquency rate among ICR users was below that among users of the standard plan and about the same as that among users of extended and graduated plans. Even for DCS consolidation loans, ICR users had a lower delinquency rate compared with those in the three other plans. However, with over half of DCS consolidation loans under the ICR plan, the influence of these loans' high delinquency rate is felt primarily by ICR.[7]

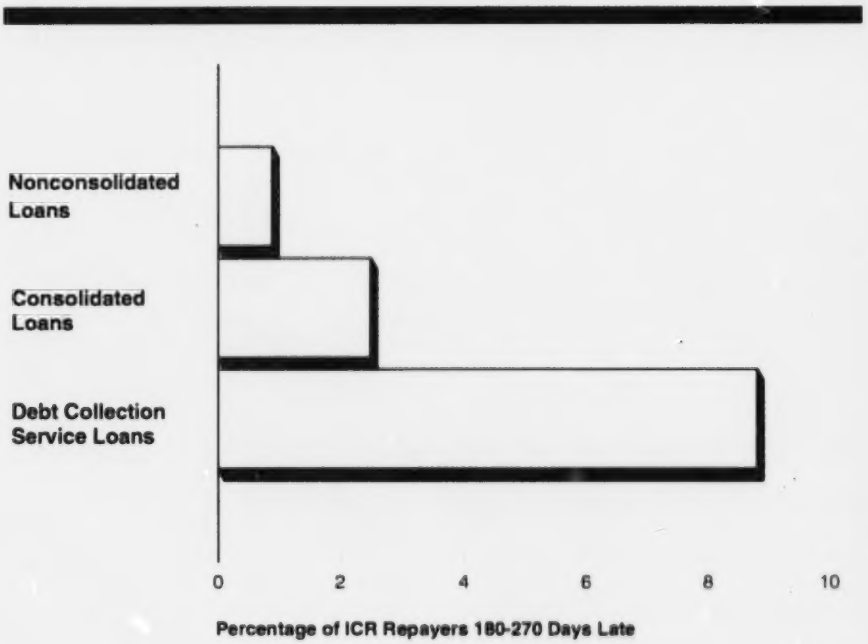
[7]For details on delinquency rates among ICR users and users of the other repayment plans, see app. IV.

Figure 6: Comparison of Delinquency Rates Across Four Repayment Plans by Type of FDLP Loan



FDLP loan default patterns are similar to those for delinquencies. Among borrowers using ICR, the percentage of loans in default is much higher for DCS consolidation loans than for nonconsolidated or direct consolidated loans (see fig. 7). ICR users who had DCS consolidation loans defaulted at a rate of 8.8 percent, compared with rates of 0.9 percent and 2.5 percent for ICR users with nonconsolidated and direct consolidation loans, respectively. Again, given the concentration of borrowers with DCS consolidation loans in the ICR plan, ICR's overall high percentage of loans in default is strongly affected by this one type of loan.

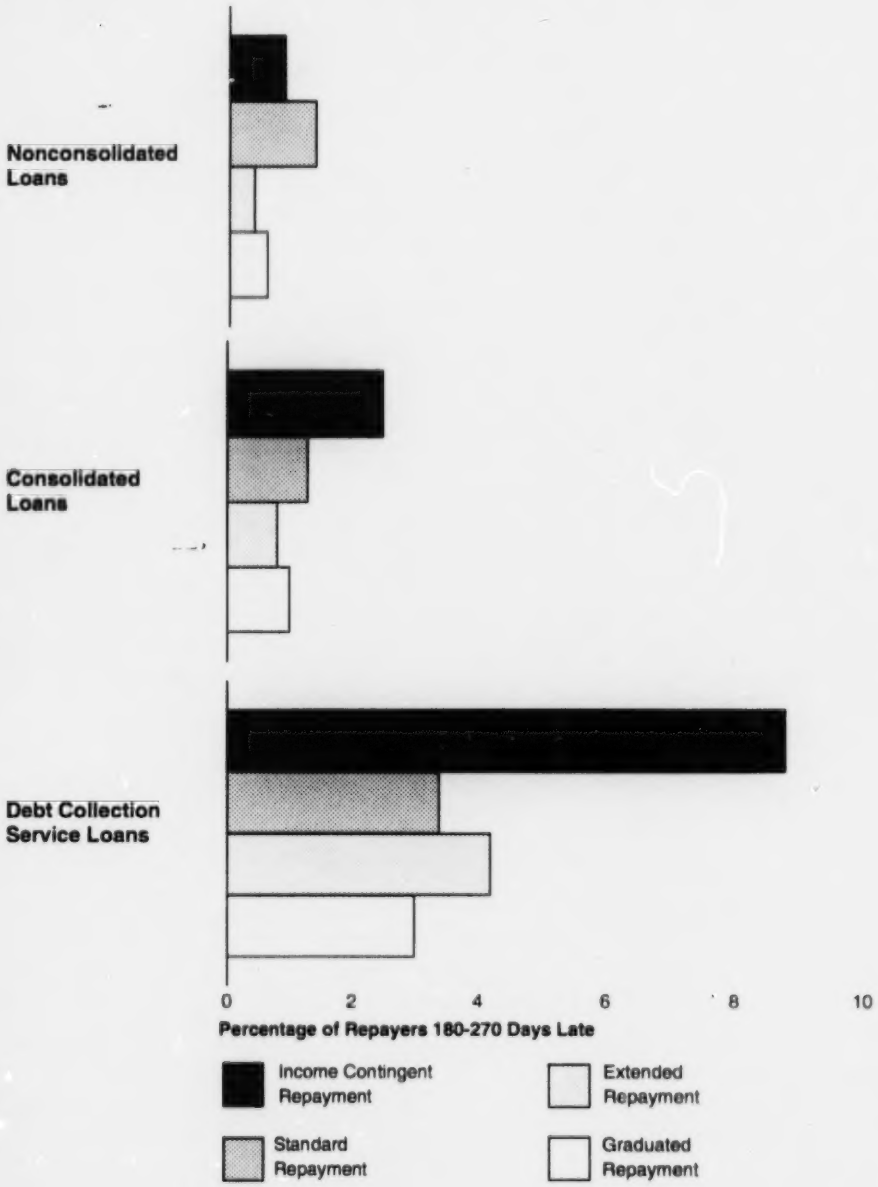
Figure 7: Percent of Borrowers Using ICR That Were in Default 181 to 270 Days, as of March 31, 1997



As with delinquencies, a comparison of individual types of loans shows that ICR users did not have higher percentages of loans in default across the board than users of other repayment plans (see fig. 8). However, ICR users did have the highest percentage of loans in default for two of the three loan types.[8]

[8]For details on defaults among ICR users and users of the other repayment plans, see app. V.

Figure 8: Comparison of Percentage of Borrowers in Default 181 to 270 Days Across Four Repayment Plans by Type of FDLP Loan



Total Borrower Payments Under ICR Are Higher in Some Circumstances, Lower in Others

There is no single answer to whether a borrower will pay more or less under ICR compared with standard, extended, or graduated plans. Borrowers for whom ICR was primarily designed (that is, borrowers with a limited ability to pay) could face relatively higher total payments in the form of larger total interest costs and tax liability—on amounts they were not able to repay within the 25-year loan repayment limit. In contrast, ICR may be less costly than the extended or graduated plans for borrowers with considerably greater ability to repay their loans.

To provide some indication of how the type of repayment plan affects a borrower's initial monthly payment amount and total loan payments, we compared the four plans with two different starting incomes—$15,000 and $45,000.[9]

Lower Income Scenario: Starting Income of $15,000

This scenario assumes that (1) the borrower and spouse have an initial annual combined income at the beginning of the repayment period of $15,000 and receive annual income increases of 5 percent over the repayment period, (2) the borrower is married throughout with no children, and (3) the loan interest rate is 8.25 percent. Table 3 shows how the size of a loan affects the initial monthly payment amounts under the ICR plan compared with the other repayment plans.

Table 3: Comparison of Monthly Payment Amounts Under ICR and Other Repayment Options: Starting Income of $15,000

	Monthly payment amount			
Original loan amount	Standard	Extended	Graduated[a]	ICR
$5,000	$61	$55	$35	$34
10,000	123	97	70	68
20,000	245	170	140	77
40,000	491	315	280	77
75,000	920	563	526	77
100,000	1,227	751	701	77

[a]Initial monthly payment amounts.

The initial monthly payments for a borrower using ICR are substantially less than the initial monthly payments for the other repayment plans for

[9]We selected these income amounts because data on monthly payments and total loan payments for these income levels were readily available from the Department's 1996 Repayment Book. The Repayment Book contains plan descriptions and worksheets with formulas that borrowers can use to estimate their monthly payment amounts under the various plans. It also shows examples of what the monthly payment amounts and total payments would be under the various plans for different loan amounts, including ICR for various hypothetical borrower income amounts.

loans of $20,000 and higher. Although initial payment amounts under the other plans increase for larger loan amounts, the payments under ICR increase to a much lesser extent and stop increasing at loans above $20,000. Under ICR, borrowers' payment amounts are capped at 20 percent of their discretionary income.[10] Thus, a borrower with an income of $15,000 and $100,000 in loans would pay no more per month under ICR than a borrower with the same income and an initial loan amount of $20,000.

The size of a borrower's monthly payment has a direct effect on his or her total loan payments. Those payments include the amounts to repay principal and interest, and ICR users can also incur a cost for the potential tax liability on the loan balance that remains unpaid after 25 years. Unpaid loan balances are forgiven at the end of the 25-year period but must be treated as taxable income.[11] Whether the lower income borrower under ICR actually pays more or less than borrowers using alternatives depends in part on the amount borrowed (see table 4).

Table 4: Comparison of Repayment Amounts Under ICR and Other Repayment Options: Starting Income of $15,000

	Total repayment amount by repayment plan (principal and interest)				ICR borrower's unpaid balance after 25 years
Original loan amount	Standard	Extended	Graduated	ICR	
$5,000	$7,359	$7,893	$8,655	$12,016	$1,285
10,000	14,718	17,463	19,085	23,965	2,570
20,000	29,437	40,899	44,115	44,235	20,780
40,000	58,873	94,614	100,567	64,918	65,605
75,000	110,387	202,842	212,324	67,638	177,208
100,000	147,183	270,456	283,098	67,638	259,072

A borrower with an initial income of $15,000 and loans ranging from $5,000 to $10,000 would pay more under ICR than under the other plans. In contrast, a borrower with $40,000 or more in loans would repay far less under ICR than under the extended and graduated alternatives because under these two plans the borrower pays off the total loan; the borrower using ICR would not. However, a borrower using ICR has to contend with having to declare the unpaid balance of the loans as income—and possibly

[10]The Department defines discretionary income as the portion of adjusted gross income (AGI) that remains after deducting an allowance for basic living costs as specified in the Department of Health and Human Service's Poverty Guidelines. In 1997, the allowance for a family of two in the 48 contiguous states and Washington, D.C., was $10,610.

[11]Legislation introduced in the 105th Congress, if enacted, would discharge a borrower's unpaid balance at the end of the repayment period, excluding it from tax.

incur a tax liability. As loan amounts increase, the potential tax liability rises substantially for borrowers at this income level.

Higher Income Scenario: Starting Income of $45,000

This scenario makes the same assumptions as the first, except that calculations are based on a starting income of $45,000. ICR does not provide the same lower monthly payment advantages over the other plans as it does for lower income borrowers. Initially, as table 5 illustrates, ICR has consistently lower monthly payments than the standard plan but higher monthly payments than the extended and graduated plans, except for loans at the $100,000 level.

Table 5: Comparison of Monthly Payment Amounts Under ICR and Other Repayment Options: Starting Income of $45,000

	Monthly payment amount			
Original loan amount	Standard	Extended	Graduated[a]	ICR[a]
$5,000	$61	$55	$35	$56
10,000	123	97	70	112
20,000	245	170	140	225
40,000	491	315	280	450
75,000	920	563	526	577
100,000	1,227	751	701	577

[a]Initial monthly payment amounts.

Table 6 compares total loan payments that a borrower and spouse with a starting combined income of $45,000 would pay under each of the four repayment plans for loan amounts ranging from $5,000 to $100,000. As it shows, payments for principal and interest under ICR are always higher than under standard repayment but always lower than under the extended or graduated plans. Unlike the borrower who begins with a $15,000 income, the borrower with an initial income of $45,000 has no unpaid balance after 25 years for any of the loan amounts illustrated.

Table 6: Comparison of Repayment Amounts Under ICR and Other Repayment Options: Starting Income of $45,000

Original loan amount	Total repayment amount by repayment plan (principal and interest)				ICR borrower's unpaid balance after 25 years
	Standard	Extended	Graduated	ICR	
$5,000	$7,359	$7,893	$8,655	$7,559	0
10,000	14,718	17,463	19,085	15,117	0
20,000	29,437	40,899	44,115	30,235	0
40,000	58,873	94,614	100,567	60,470	0
75,000	110,387	202,842	212,324	133,081	0
100,000	147,183	270,456	283,098	229,664	0

Measures Taken to Obtain and Verify Borrower Income Information

Information on borrower income for computing monthly payment amounts for the ICR plan is obtained from either documentation provided by the borrower or information from IRS on the borrower's AGI as reported on his or her federal income tax return.

The monthly payment amount for borrowers in their first year of repayment is based on documentation and other information submitted by borrowers to the Department's direct loan servicing center. This documentation, referred to as "alternative documentation of income," can be recent pay stubs, dividend statements, canceled checks, or a statement signed by the borrowers explaining their source of income.

According to a Department official, the Department uses alternative documentation for borrowers in their first year of repayment because, in most cases, AGI information from IRS is zero or close to zero. AGI reflects prior-year income when borrowers were generally in school or not working full time and were reporting little or no taxable income. However, most borrowers have income, and the alternative documentation captures it. This kind of documentation is also used in other situations when borrowers' AGI does not reflect their current income, such as when a borrower becomes unemployed.

According to Department officials, service center personnel do not conduct credit checks or contact employers to verify the accuracy of borrowers' information. However, when borrowers submit this documentation, they also certify that they are providing accurate and complete income information.

After ICR users have been out of school for at least 1 year, their monthly payment amount is based on their AGI as reported on their federal income

tax returns. To obtain this information, the service center sends computer tapes containing borrower identification information to IRS, which matches this information against its records. IRS then sends computer tapes containing borrower AGI information directly to the service center. After receiving the IRS tapes, service center personnel run edit checks for quality assurance.

According to Department officials, the Department does not verify the accuracy of the information the borrowers provide IRS on their tax returns. Rather, it relies on the IRS' own audits, edits, and verifications to make sure borrowers' AGI is accurate. However, other measures are taken in certain circumstances to ensure the accuracy and reasonableness of borrowers' income information. For example, if a borrower is required to provide alternative documentation of income because his or her AGI would reflect an in-school period, the servicer still obtains AGI information from IRS to see how accurately borrower-reported information from the previous year reflected IRS-reported information for that year.

According to Department officials, borrowers falsifying their income to reduce their monthly payments lengthen the time required to pay off their loans, which ultimately costs them more money. The officials also said that borrowers who do not cooperate in providing accurate income information are automatically removed from the ICR plan and placed into the standard repayment plan.

Agency Comments

The Department of Education reviewed a draft of this report and had no written comments, although it provided technical suggestions that we incorporated as appropriate.

Copies of this report are being sent to the Chairman of the Senate Committee on Labor and Human Resources, the Secretary of Education, appropriate congressional committees and Members, and others who are interested.

If you have any questions about this report, please call me or Joseph J. Eglin, Jr., Assistant Director, at (202) 512-7014. Major contributors to this report include Joan A. Denomme, Charles M. Novak, and Charles H. Shervey.

Sincerely yours,

Carlotta Joyner

Carlotta C. Joyner
Director, Education and
Employment Issues

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Abbreviations

AGI	adjusted gross income
DCS	Debt Collection Service
FDLP	William D. Ford Federal Direct Loan Program
FFELP	Federal Family Education Loan Program
ICR	income contingent repayment
IRS	Internal Revenue Service

Scope and Methodology

To determine the extent to which borrowers are using the income contingent repayment (ICR) plan compared with other repayment plans, we obtained and analyzed data from the Department of Education on Federal Direct Loan Programs (FDLP) loans being repaid as of March 31, 1997. To determine the extent to which borrowers at the various kinds of schools used the different types of repayment plans, we obtained and analyzed data on nonconsolidated loans. Data on consolidation and DCS consolidation loans categorized by kind of school were not available. A Department official said that such data are not captured in the Department databases we used for our analysis.

To determine the extent to which loans being repaid under ICR and other repayment plans were delinquent or in default, we computed simple percentages that reflect the proportion of total borrowers or dollar amounts of loans in repayment classified as delinquent or in default on March 31, 1997.

The percentages we computed are not comparable to the annual cohort default rates the Department computes in accordance with the Higher Education Act of 1965, as amended, and its Default Reduction Initiative. The cohort default rate is computed to determine whether to allow schools to participate in federal student loan programs—schools with cohort default rates above certain statutory thresholds can be dropped or prevented from participating in these programs. In general, cohort default rates reflect the percentage of a school's borrowers who enter repayment in one fiscal year and default by the end of the next fiscal year.

To compare borrowers' total payments under ICR and other repayment plans, we used information from selected hypothetical examples contained in the Department's 1996 Repayment Book. Data on unpaid loan balances remaining at the end of the repayment period for loans being repaid under the ICR plan—for the various hypothetical scenarios we used—were not contained in the Repayment Book. Therefore, we asked the Department to compute these figures, and we used them in our analyses.

To determine the extent to which the Department or its FDLP service center verifies the accuracy of borrowers' income information, we reviewed Department regulations and guidelines. We also interviewed Department officials to obtain additional information on these procedures.

Our work was conducted from February to June 1997 in accordance with generally accepted government auditing standards.

Data on FDLP Loans in Repayment

Table II.1: Repayment Plans Selected by Borrowers of All Kinds of FDLP Loans, as of March 31, 1997

	Borrower		Original loan amount		
Repayment plan	Number	Percentage of total	Amount (in millions)	Percentage of total	Average loan amounts
Standard	527,351	79.5	$3,442.4	64.8	$6,528
Extended	20,139	3.0	342.4	6.4	17,000
Graduated	59,510	9.0	696.4	13.1	11,703
ICR	56,298	8.5	831.3	15.7	14,767
Total	**663,298**	**100.0**	**$5,312.5**	**100.0**	**$8,009**

Table II.2: Repayment Plans Selected by Borrowers With Nonconsolidated Loans, as of March 31, 1997

	Borrower		Original loan amount		
Repayment plan	Number	Percentage of total	Amount (in millions)	Percentage of total	Average loan amounts
Standard	496,222	89.5	$3,130.8	85.4	$6,309
Extended	11,859	2.1	120.6	3.3	10,172
Graduated	42,648	7.7	383.6	10.5	8,994
ICR	3,732	0.7	30.3	0.8	8,118
Total	**554,461**	**100.0**	**$3,665.3**	**100.0**	**$6,611**

Table II.3: Repayment Plans Selected by Borrowers With Direct Consolidation Loans, as of March 31, 1997

	Borrower		Original loan amount		
Repayment plan	Number	Percentage of total	Amount (in millions)	Percentage of total	Average loan amounts
Standard	16,538	25.7	$250.1	17.8	$15,122
Extended	7,005	10.9	212.9	15.2	30,388
Graduated	11,999	18.6	286.0	20.4	23,833
ICR	28,888	44.8	656.1	46.7	22,712
Total	**64,430**	**100.0**	**$1,405.0**	**100.0**	**$21,807**

Note: Numbers do not add to total due to rounding.

Table II.4: Repayment Plans Selected by Borrowers With DCS Consolidation Loans, as of March 31, 1997

	Borrower		Original loan amount		
Repayment plan	**Number**	**Percentage of total**	**Amount (in millions)**	**Percentage of total**	**Average loan amounts**
Standard	14,591	32.9	$61.5	25.4	$4,212
Extended	1,275	2.9	8.9	3.7	6,964
Graduated	4,863	11.0	26.9	11.1	5,526
ICR	23,678	53.3	144.9	59.9	6,121
Total	**44,407**	**100.0**	**$242.1**	**100.0**	**$5,453**

Note: Numbers do not add to total due to rounding.

Kinds of Schools Attended by Nonconsolidated Loan Borrowers

Table III.1: Nonconsolidated Loan Borrowers in Repayment by Payment Plan and Kind of School, as of March 31, 1997

	Standard	
Kind of school	Number	Percentage of school total
2-year private	6,418	92.36
2-year public	25,402	92.88
4-year private	93,756	86.91
4-year public	319,370	89.62
Proprietary	51,276	91.68
Total	**496,222**	**89.50**

Extended		Graduated		ICR		Total	
Number	Percentage of school total	Number	Percentage of school total	Number	Percentage of school total	Number	Percentage of school total
126	1.81	374	5.38	31	0.45	6,949	100.00
274	1.00	1,396	5.10	276	1.01	27,348	100.00
3,425	3.17	9,897	9.17	797	0.74	107,875	100.00
7,244	2.03	27,485	7.71	2,261	0.63	356,360	100.00
790	1.41	3,496	6.25	367	0.66	55,929	100.00
11,859	**2.14**	**42,648**	**7.69**	**3,732**	**0.67**	**554,461**	**100.00**

Table III.2: Dollar Volume of Nonconsolidated Loans in Repayment by Payment Plan and Kind of School, as of March 31, 1997

Dollars in millions

	Standard	
Kind of school	**Loan volume**	**Percentage of school total**
2-year private	$28.4	88.92
2-year public	81.3	91.38
4-year private	734.6	81.60
4-year public	2,059.4	86.23
Proprietary	227.2	88.74
Total	**$3,130.8**	**85.42**

Extended		Graduated		ICR		Total	
Loan volume	Percentage of school total	Loan volume	Percentage of school total	Loan volume	Percentage of school total	Loan volume	Percentage of school total
$1.0	3.03	$2.5	7.73	$0.1	0.32	$31.9	100.00
1.2	1.34	5.5	6.24	.9	1.04	89.0	100.00
44.1	4.89	111.8	12.43	9.7	1.08	900.2	100.00
69.2	2.90	241.9	10.13	17.8	0.75	2,388.3	100.00
5.2	2.04	21.8	8.51	1.8	0.70	256.0	100.00
$120.6	**3.29**	**$383.6**	**10.47**	**$30.3**	**0.83**	**$3,665.3**	**100.00**

Note: Numbers do not add to total due to rounding.

Delinquency Rates of FDLP Borrowers

Table IV.1: Delinquency Rates of Borrowers Repaying Under ICR, as of March 31, 1997

Loan category	Borrower		Percentage delinquent
	Delinquent	Total	
Direct nonconsolidated	358	3,732	**9.6**
Direct consolidation	4,230	28,888	**14.6**
DCS consolidation	4,499	23,678	**19.0**
Total	9,087	56,298	**16.1**

Table IV.2: Delinquency Rates of Nonconsolidated Loan Borrowers by Kind of Repayment Plan, as of March 31, 1997

Repayment plan	Borrower		Percentage delinquent
	Delinquent	Total	
Standard	72,424	496,222	**14.6**
Extended	984	11,859	**8.3**
Graduated	4,096	42,648	**9.6**
ICR	358	3,732	**9.6**
Total	77,862	554,461	**14.0**

Table IV.3: Delinquency Rates of Direct Consolidation Loan Borrowers by Kind of Repayment Plan, as of March 31, 1997

Repayment plan	Borrower		Percentage delinquent
	Delinquent	Total	
Standard	1,707	16,538	**10.3**
Extended	558	7,005	**8.0**
Graduated	1,316	11,999	**11.0**
ICR	4,230	28,888	**14.6**
Total	7,811	64,430	**12.1**

Table IV.4: Delinquency Rates of DCS Consolidation Loan Borrowers by Kind of Repayment Plan, as of March 31, 1997

Repayment plan	Borrower		Percentage delinquent
	Delinquent	Total	
Standard	3,792	14,591	**26.0**
Extended	296	1,275	**23.2**
Graduated	1,068	4,863	**22.0**
ICR	4,499	23,678	**19.0**
Total	9,655	44,407	**21.7**

Defaults of FDLP Borrowers

Table V.1: Percentage of Loans in Default for Borrowers Repaying Under ICR, as of March 31, 1997

Loan category	Borrower		Percentage in default
	In default	Total	
Direct nonconsolidated	34	3,732	**0.9**
Direct consolidation	715	28,888	**2.5**
DCS consolidation	2,083	23,678	**8.8**
Total	2,832	56,298	**5.0**

Table V.2: Percentage of Loans in Default for Direct Nonconsolidated Loan Borrowers by Kind of Repayment Plan, as of March 31, 1997

Repayment plan	Borrower		Percentage in default
	In default	Total	
Standard	6,823	496,222	**1.4**
Extended	51	11,859	**0.4**
Graduated	233	42,648	**0.6**
ICR	4	3,732	**0.9**
Total	7,141	554,461	**1.3**

Table V.3: Percentage of Loans in Default for Direct Consolidation Loan Borrowers by Kind of Repayment Plan, as of March 31, 1997

Repayment plan	Borrower		Percentage in default
	In default	Total	
Standard	216	16,538	**1.3**
Extended	54	7,005	**0.8**
Graduated	123	11,999	**1.0**
ICR	715	28,888	**2.5**
Total	1,108	64,430	**1.7**

Table V.4: Percentage of Loans in Default for DCS Consolidation Loan Borrowers by Kind of Repayment Plan, as of March 31, 1997

Repayment plan	Borrower		Percentage in default
	In default	Total	
Standard	495	14,591	**3.4**
Extended	53	1,275	**4.2**
Graduated	146	4,863	**3.0**
ICR	2,083	23,678	**8.8**
Total	2,777	44,407	**6.3**

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